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**PEN MEETING ITEM****MEMORANDUM**

Arizona Corporation Commission

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AZ CORP COMMISSION

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TO: THE COMMISSION

OCT 1 1996

FROM: Utilities Division

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DATE: October 1, 1996

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RE: IN THE MATTER OF THE COMPETITION IN THE PROVISION OF ELECTRIC SERVICES THROUGHOUT THE STATE OF ARIZONA  
(DOCKET NO. U-0000-94-165)

The Commission, on May 20, 1994, established Docket No. U-0000-94-165 to investigate the introduction of retail electric competition in Arizona. To that end, a number of activities have been undertaken:

- ♦ *An introductory workshop was held on September 7, 1994. One hundred eighteen representatives from utilities, consumer organizations, other power suppliers, and others attended the workshop. The workshop was summarized in a Staff Report dated October, 1994.*
- ♦ *A series of nine working group and task force meetings were held in 1995 which addressed restructuring options, implementation of the options, and advantages and disadvantages of the options. Fifty-one groups were represented on task forces which focused on systems and markets, regulatory issues, and energy efficiency and environmental issues. Members of the task forces included representatives from utilities, consumer organizations, other power suppliers, and others. This work was summarized in a "Report of the Working Group on Retail Electric Competition," dated October 5, 1995.*
- ♦ *A request for comments on how to implement electric industry restructuring was issued in February 1996. Comments were filed by 31 parties on June 28, 1996. Commenters included consumer groups, Arizona utilities, other suppliers, and other parties. Staff prepared a summary of the comments in July 1996.*
- ♦ *A workshop was held on August 12, 1996 to explore and obtain feedback on a small number of options developed from the comments for introducing retail electric competition. One hundred thirty workshop participants included representatives from utilities, consumer organizations, other power suppliers, and others. Staff summarized the workshop in a report dated August 19, 1996.*
- ♦ *Requests for comments on a rule that was drafted after the August 12 workshop to phase-in retail electric competition were issued. The requests were sent out on August 28, 1996 and comments were due September 12, 1996. Comments were provided by 30 utilities, consumer organizations, other power suppliers, and others.*

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- ♦ *A workshop to discuss a revised draft rule was held on September 18, 1996. Ninety individuals attended the workshop including representatives from utilities, consumer organizations, other power suppliers, and others.*

Based upon the information gathered since 1994, Staff is now proposing a rule to phase in retail electric competition. The major features of the proposed rule are outlined below:

- ♦ All regulated electric utilities except for those cooperatives which are located largely in other states are required to phase in retail electric competition.
- ♦ The date of December 31, 1997 is established as the due date for several utility filings dealing with standard and unbundled service offerings in compliance with the proposed rule. Prior to the filings, Staff will conduct workshops to allow utilities and others the opportunity to work out specific implementation details on: selection processes for participants in the phase-in; unbundled and standard service offerings; and analysis and recovery of stranded investment. In addition, an on-going working group on system reliability is established.
- ♦ Companies intending to supply competitive electric services ("Electric Service Providers") are required to obtain a Certificate of Convenience and Necessity from the Commission.
- ♦ Three competitive phases are proposed: at least 20 percent of demand is open to competition by January 1, 1999; at least 50 percent of demand is open to competition by January 1, 2001; all retail demand may be competitively procured starting January 1, 2003. All classes of consumers may participate in the competitive market from the outset and no one consumer, such as a large industrial consumer, may dominate the available competitive service. Utilities must propose how they will select participants for the first two phases.
- ♦ Generation service will be competitive. In addition, metering and meter reading services, billing and collection services, information services, and transmission and ancillary services can be competitively provided if doing so is consistent with Federal Energy Regulatory Commission requirements.
- ♦ Incumbent utilities are obligated to provide two types of services:
  - 1) Standard offer service which consists of regulated, bundled electric services that are available to consumers who do not participate in the competitive market. Existing tariffed services could constitute the standard offer, although utilities could file new rates for standard offer service. Standard offer service is

provided until the Commission determines that competition has been substantially implemented. Rates for standard offers must reflect the costs of providing the standard services.

- 2) Unbundled service at regulated rates to make the distribution and transmission system available to buyers and sellers in the competitive market. Rates would reflect the costs of providing the service.

Tariffs for standard offer service and unbundled services are to be filed by December 31, 1997. It is anticipated that the Commission would conduct hearings to review utility filings for standard offer service and unbundled services.

- ◆ Stranded costs are recoverable. Stranded costs reflect the diminution in value of utility assets or obligations to furnish electricity as a result of competition. Utilities must mitigate or offset their stranded costs to the maximum degree possible. If there is any remaining stranded cost, utilities must file with the Commission an estimate of unmitigated stranded cost and a mechanism to recover unmitigated stranded cost from customers participating in the competitive market. In determining the mechanism and charges to recover stranded cost, the Commission must consider several factors including: the impact on competition and consumers; the impact on consumer not participating in the competitive market; the time period over which stranded costs are recovered; the degree of mitigation of stranded costs; the ease of determining the magnitude of stranded costs; and the amount of renewables used by the utility. It is anticipated that stranded cost estimates and charges would be updated regularly.
- ◆ System benefits charges are required to recover from participants in the competitive market the costs of utility demand side management, low income, environmental, renewables, and nuclear power plant decommissioning programs. A non-bypassable charge reflecting consumers' shares of these costs is to be proposed by December 31, 1997.
- ◆ A solar portfolio standard is established to encourage photovoltaics and solar thermal power generation (such as solar dish or trough technologies). During the period January 1, 1999 through December 31, 2001, at least one half of one percent of the total retail energy sold competitively must come from photovoltaic or solar thermal generation resources installed after January 1, 1997. After December 31, 2001, the percentage increases to one percent. To encourage an early start for solar generation, a seller can credit to the solar portfolio standard two times the electric energy generated before January 1, 1999 using photovoltaics or solar thermal resources installed after January 1, 1997.

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- ◆ The Commission will consider development of spot markets and independent system operators. Such an endeavor is likely to involve the efforts of the industry and several states.
- ◆ Any electric utility subject to the Commission's jurisdiction and which is not required to participate in the competitive market may voluntarily open its service territory to competition, and sell competitively in the service territories of the other utilities if it obtains a Certificate of Convenience and Necessity and agrees to comply with the proposed rule. The role of municipalities and political subdivisions in the competitive market will be determined by the Legislature.
- ◆ Sellers of competitive electric service will file tariffs for Commission approval. These tariffs will describe the services and maximum rates. Services may be priced below the maximum rate as long as rates cover marginal cost. Customized contracts would not require specific Commission approval, but large customized contracts would be filed for informational purposes prior to the date full competition begins. Contracts would not be public information.
- ◆ The proposed rule adopts existing service quality, consumer protection, safety, and billing rules. It also includes a provision requiring that a seller must reinstate the previous supplier's service (at the seller's cost) if that seller did not obtain written authorization from the consumer to switch suppliers.
- ◆ In anticipation of the need for consumer education, the proposed rule indicates that the Commission may require sellers to provide notification and informational materials to consumers about competition and consumer choices.
- ◆ Reports are required of all sellers to inform the Commission about the progress of competition. At first, reports are to be submitted semi-annually; reports later are to be submitted annually.
- ◆ Variations or exemptions from parts of the rule could be granted by the Commission.
- ◆ The Commission may develop procedures for resolving disputes regarding implementation of retail electric competition.

Staff believes that the proposed rule will benefit Arizona consumers by: creating consumer choice among energy suppliers; customizing energy services to consumer needs; stimulating innovation in technology; encouraging energy efficiency; and lowering prices relative to regulated rates. These benefits are achievable while limiting adverse financial impacts of competition on utilities; maintaining transmission and generation system reliability; countering

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the market power of vertically integrated utilities; promoting solar resources; protecting important public programs such as low income programs and demand side management programs; and protecting consumers who do not participate in the early phases of competition. Staff concludes that the proposed rule is in the public interest.

Staff, therefore, recommends that this proposed rule be forwarded to the Secretary of State for notice of proposed rule making. Staff further recommends that the Hearing Division schedule oral proceedings on December 2, 3, and 4, 1996, or as soon thereafter as is practicable, in Phoenix, Tucson, and Kingman, Arizona, respectively.



Gary Yaquinto  
Director  
Utilities Division

GY:DB:KEC:RTW:lhk/BAB

ORIGINATORS: David Berry, Kim Clark, Ray Williamson

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ARIZONA CORPORATION COMMISSION

October 1, 1996

Dear Colleague:

Enclosed is the Commission Staff's proposed rule on electric industry restructuring (Docket No. U-0000-94-165). Staff is proposing that the Commission initiate the rule-making process to introduce retail electric competition. This is only a Staff recommendation to the Commission; it has not yet become an order of the Commission. The Commission can decide to accept, amend or reject Staff's proposed order.

This matter is scheduled for Commission deliberation at its special Open Meeting on October 8, 1996, at 10:00 a.m., and for a Commission decision at its regular Open Meeting on October 9, 1996, at 10:00 a.m.

If you have any questions about this matter, please contact me at (602) 542-4251. You may also contact Staff members David Berry at (602) 542-0742, Kim Clark at (602) 542-0824, or Ray Williamson at (602) 542-0828.

Sincerely,

A handwritten signature in dark ink, appearing to read "Gary Yaquinto", is written over a horizontal line.

Gary Yaquinto  
Director  
Utilities Division

GY:DB:KC:RW:lh

Enclosures